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IRS Issues Interim Guidance on Asset Valuation Rules for Single-Employer Defined Benefit Plans

The IRS has issued Notice 2009-22, which provides interim guidance on asset valuation methods for minimum funding purposes after changes made by the Worker, Retiree, and Employer Recovery Act of 2008. Importantly, the notice provides automatic approval for changes in asset valuation methods for 2009 plan years.

Background

The Worker, Retiree, and Employer Recovery Act of 2008 (WRERA), signed by President Bush in December 2008, amended the asset valuation rules for single-employer defined benefit plans contained in the Pension Protection Act (PPA). (See our December 15, 2008 *For Your Information*.) PPA asset valuation rules allowed a plan sponsor to use an asset method which averaged the market value of plan assets, after adjusting for contributions and disbursements, over a period of up to two years prior to the valuation date. WRERA amended PPA to provide that such an asset method should also remove the “expected return on plan assets” from the average. The resulting method is generally referred to as “asset smoothing” because it is similar to pre-PPA asset valuation methods.

> ***BUCK COMMENT.*** *WRERA-permitted asset smoothing produces a less volatile asset value that cannot be less than originally allowed under PPA.*

The IRS issued proposed regulations in December 2007 that included guidance on the asset valuation provisions of PPA. These regulations were proposed to take effect for plan years beginning in 2009, with good faith reliance permitted for plan years beginning in 2008. WRERA changes to PPA asset valuation provisions are effective as of the first plan year to which the funding requirements of PPA apply, which for most plans is the first plan year beginning on or after January 1, 2008. This created uncertainty about whether retroactive recalculation was required for 2008, how to calculate funding contributions and plan funding percentages for at-risk status and benefit restrictions for 2008 plan years, what consequences might result from retroactively changing the asset valuation method for 2008, and whether the IRS would grant automatic approval for asset method changes from 2008 to 2009.

Notice 2009-22

The IRS has now issued Notice 2009-22, which clarifies many areas of the WRERA asset valuation rules. This interim guidance applies for plan years beginning in 2008 and 2009 and “describes the rules expected to be incorporated in future regulations.”

In addition to clarifying the "expected return on plan assets" provision of WRERA and answering some technical questions, the notice affirms the fundamental structure of the 2007 proposed regulations. (See our January 11, 2008 *For Your Information*.)

Retroactivity

Notice 2009-22 provides that plans need not reflect the changes made by WRERA in their 2008 plan year asset valuation. Therefore, plan sponsors may, but need not, change the 2008 asset valuation method to reflect the new requirements.

BUCK COMMENT. *Adjusting the averaging process for expected asset return would increase the average asset value and could result in the retroactive elimination of a previously applied benefit restriction, eliminate a previously determined "at-risk" status, and/or permit use of a previously prohibited carryover balance to meet required minimum and required quarterly contributions. It could also reduce the maximum deductible limit for 2008 contributions.*

Expected Return on Assets

Notice 2009-22 addresses the WRERA requirement to exclude an "expected return on plan assets" from asset averaging (i.e., effectively permitting asset "smoothing") by defining the expected rate of return for any period as the lesser of the Enrolled Actuary's best estimate of the anticipated long-term rate of return on plan assets, and the third segment rate applicable to the period. (The "third segment rate" is the PPA discount rate for valuing benefit payments expected to be paid more than 20 years after the valuation date.) The notice provides that the applicable third segment rate is fixed at the start of each plan year and takes into account the lookback and transition elections made by the plan sponsor. Plans that use the full yield curve rather than segment rates to value liabilities use the third segment rate with no lookback. For valuation dates prior to September 1, 2007, the applicable third segment rate is the previously published rate without 24-month averaging, transition or lookback, for the month preceding the valuation date. Finally, if an asset measurement period crosses two plan years, the third segment rate to be used for that period is the lesser of the two rates.

BUCK COMMENT. *The requirement that plans that use a full yield curve to value their liabilities use the third segment rate without lookback for calculating expected return is consistent with the IRS position taken in proposed regulations that no lookback is available for such plans for valuing plan liabilities, despite the wording in PPA that would seem to permit a lookback.*

Receivable Contributions Included

Notice 2009-22 also clarifies that the asset values to be averaged, and the expected return on plan assets, should be calculated by including the discounted value of receivable contributions for the prior plan year, as long as those contributions are actually made by 8½ months after the end of the plan year. Receivable contributions for years after 2007 are discounted to the asset measurement date using the plan's effective interest rate for the prior plan year (i.e., the single interest rate that would reproduce the plan's target liability). No discount is applied to receivable contributions for plan years prior to 2008. Also, the discounted value of receivable contributions is included in the calculation of the 90% - 110% corridor around fair market value that constrains the averaged asset value.

Timing of Contributions and Disbursements

WRERA did not change the PPA requirement to exclude contributions, benefit distributions, and plan expenses from asset averaging. Notice 2009-22 specifies that the actual timing of these adjustments must be taken into account for calculating average asset values. For example, using mid-period timing is incorrect for plans that pay benefits at the start of each month, or for plans with uneven incidence of expenses (e.g., PBGC premiums, lump sum payments).

Automatic Approval for Method Changes

For 2008, a sponsor may choose to use market value, any method that complies with the proposed IRS regulations, or any method that complies with Notice 2009-22. For 2009, the notice allows a sponsor to choose market value or any method that complies with the notice, regardless of whether this method is the same as the method used for 2008. If the 2009 asset method differs from the 2008 asset method, automatic approval for that change is granted provided the 2009 method is market value or complies with the notice.

Conclusion

Notice 2009-22 provides much needed guidance on permissible asset averaging methods. Automatic approval for changing asset methods in 2009 is especially welcome.

Buck's consultants are ready to discuss this guidance with you and appropriate alternatives for your plans.